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No. 87-1097

In the Supreme Court of the United States

OCTOBER TERM, 1987

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, PETITIONER

v.

GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE PETITIONER

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59 pp

QUESTIONS PRESENTED

1. Whether the Administrative Procedure Act, 5 U.S.C. (& Supp. IV) 551 *et seq.*, prohibits an agency from promulgating retroactive regulations even if the decision to apply a regulation retroactively is not arbitrary, capricious, an abuse of discretion, or otherwise contrary to law.

2. Whether Section 1861(v)(1)(A)(ii) of the Medicare Act, 42 U.S.C. (Supp. III) 1395x(v)(1)(A)(ii), which allows the Secretary of Health and Human Services to promulgate "regulations * * * for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive," specifically authorizes the Secretary to promulgate a retroactive regulation establishing a ceiling on reimbursement for hospitals' wage costs, and to apply that regulation in reimbursement proceedings not final at the time that the regulation was promulgated.

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, Howard University as Howard University Hospital, Tuscon Hospital Liquidating Corp. (formerly Tuscon General Hospital), Greater Southeast Community Hospital, Tuscon Medical Center, St. Cloud Hospital, and Community Hospital of Battle Creek were plaintiffs in actions in the district court. These parties also were appellees in the court of appeals.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Cases – Continued: Page

Cases – Continued: Page

Miscellaneous – Continued: Page

Miscellaneous – Continued: Page

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-19a) is reported at 821 F.2d 750. The opinion and order of the district court (Pet. App. 20a-42a) are unreported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 43a-44a) was entered on June 26, 1987. A petition for rehearing was denied on September 1, 1987 (Pet. App. 45a-46a). On November 23, 1987, Chief Justice Rehnquist extended the time for filing a petition for a writ of certiorari to and including December 30, 1987. The Secretary filed a petition for a writ of certiorari on that date. This Court granted certiorari on February 29, 1988. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

STATUTES INVOLVED

5 U.S.C. 551 provides in pertinent part:

For the purpose of this subchapter—

* * * * *

(4) "rule" means the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency * * *.

42 U.S.C. (Supp. III) 1395x(v)(1)(A) provides in pertinent part:

The reasonable cost of any services shall be the cost actually incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services, and shall be determined in accordance with regulations establishing the method or methods to be used, and the items to be included, in determining such costs for various types or classes of institutions, agencies, and services; * * *. Such regulations may provide for determination of the costs of services on a per diem, per unit, per capita, or other basis, may provide for using different methods in different circumstances, may provide for the use of estimates of costs of particular items or services, may provide for the establishment of limits on the direct or indirect overall incurred costs or incurred costs of specific items or services or groups of items or services to be recognized as reasonable based on estimates of the costs necessary in the efficient delivery of needed health services to individuals covered by the insurance programs established under this subchapter, and may provide for the use of charges or a percentage of charges where this method

reasonably reflects the costs. Such regulations shall (i) take into account both direct and indirect costs of providers of services (excluding therefrom any such costs, including standby costs, which are determined in accordance with regulations to be unnecessary in the efficient delivery of services covered by the insurance programs established under this subchapter) in order that, under the methods of determining costs, the necessary costs of efficiently delivering covered services to individuals covered by the insurance programs established by this subchapter will not be borne by individuals not so covered, and the costs with respect to individuals not so covered will not be borne by such insurance programs, and (ii) provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive.

STATEMENT

1. At the time of the events at issue in this case, all "providers" of health care services to Medicare beneficiaries were reimbursed by the Secretary of Health and Human Services (HHS) on an annual basis for the "reasonable costs" of those health care services. 42 U.S.C. (& Supp. III) 1395f(b), 1395x(v) and (v)(1)(A).[1] Congress

[1] Most hospitals are no longer reimbursed for inpatient services to Medicare beneficiaries solely on the basis of the "reasonable cost" incurred in providing services to Medicare patients. In Title VI of the Social Security Amendments of 1983, Pub. L. No. 98-21, §§ 601-607, 97 Stat. 149-172, Congress adopted a new method of reimbursement known as the prospective payment system (PPS). Under PPS (which has been implemented over a four-year transition period beginning on October 1, 1983), hospitals are paid predetermined rates for specific

expressly authorized the Secretary to promulgate regulations "establishing the method or methods to be used, and the items to be included, in determining" reasonable costs (42 U.S.C. (Supp. III) 1395x(v)(1)(A)). Alarmed by dramatic increases in the cost of hospital care, Congress in 1972 amended the statute to authorize the Secretary to "establish[] * * * limits on the * * * costs * * * to be recognized as reasonable" (42 U.S.C. (Supp. III) 1395x(v)(1)(A)). Thus, "based on estimates of the costs necessary in the efficient delivery of needed health services," the Secretary may by regulation limit both the types and amounts of costs that are reimbursable under the Medicare program (42 U.S.C. (Supp. III) 1395x(v)(1)(A)).

In 1979, the Secretary exercised his authority to establish cost limits by promulgating a regulation that prescribed ceilings upon Medicare reimbursement for hospitals' inpatient general routine operating costs. See 44 Fed. Reg. 31806. The regulation divided these costs into two categories: wage costs and all other costs. It fixed maximum reimbursable non-wage costs on a nationwide

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services, which rates are not tied to specific costs incurred by the hospital in providing those services. See 42 U.S.C. (Supp. III) 1395ww(d), as amended by the Consolidated Omnibus Budget Reconciliation Act of 1985, Pub. L. No. 99-272, § 9102, 100 Stat. 155. Many Medicare providers are not covered by the prospective payment system, however, and continue to obtain reimbursement for their "reasonable" costs. See 42 C.F.R. 412.20-412.32 (rehabilitation hospitals, psychiatric hospitals, children's hospitals, and hospitals with average length of stay greater than 25 days are not covered by PPS); 42 C.F.R. 413.1 (reasonable cost payment system applies to skilled nursing facilities, home health agencies, and other facilities providing services other than in-hospital care). Moreover, all providers are reimbursed for some categories of costs on a reasonable cost basis. See, *e.g.*, 42 U.S.C. (& Supp. III) 1395ww(a)(4) (anesthesia services provided by nurse); 42 C.F.R. 412.2(d) (capital costs, direct medical education costs, costs for direct medical and surgical services provided by certain physicians in teaching hospitals).

basis for various categories of hospitals; the rule also set nationwide wage ceilings, but made those cost limits subject to adjustment on a hospital-by-hospital basis to account for variations in wage rates over different geographic areas. The adjustment was made by applying to the nationwide wage cost ceilings an index derived from Bureau of Labor Statistics data for hospital wages in the particular geographic area. A particular hospital's wage cost ceiling was thus dependent upon the index number for that hospital's geographic area. *Id.* at 31807-31808. The wage indices for each geographic area for hospital cost reporting periods beginning on or after July 1, 1979, were set forth in the regulation (*id.* at 31812-31813);[2] the 1980 indices were published one year later (45 Fed. Reg. 41868, 41875-41876).

In 1981, the Secretary adjusted the formula used to calculate the wage indices by excluding data concerning the wages paid by hospitals owned by the federal government. See 46 Fed. Reg. 33638-33639. The Secretary explained that "[b]ecause these hospitals typically use national pay scales, the amounts they pay their employees do not necessarily reflect area wage levels. We believe excluding data from these hospitals will help improve the accuracy of the wage index adjustment" (*id.* at 33639).

The Secretary viewed this refinement in the index methodology as a "minor technical change[]" (46 Fed. Reg. 33638 (1981)). He accordingly did not provide notice or an opportunity to comment before placing the revised index formula into effect. The Secretary further found that the public interest required that the new wage indices be placed into effect immediately (*id.* at 33640).

Several hospitals sought judicial review of the Secretary's action in the United States District Court for

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[2] The Secretary subsequently revised the cost limits for this period (see 44 Fed. Reg. 46949 (1979)).

the District of Columbia, claiming that the Secretary had violated the Administrative Procedure Act (APA), 5 U.S.C. (& Supp. IV) 551 *et seq.*, by failing to provide notice and an opportunity to comment before altering the wage index methodology. The court concluded that "the Secretary's decision to exempt the [decision to alter the index methodology] from notice and comment must be declared unlawful" because it was not supported by "good cause," within the meaning of Section 553(b)(B) of the APA (Pet. App. 58a-60a).[3] Citing the provisions of the Medicare Act limiting the availability of judicial review,[4] the district court declined to issue an injunction barring the application of the 1981 wage indices to the plaintiffs' reimbursement claims. Instead, it entered an order declaring that the revised wage indices were "invalid" (*id.* at 66a). The court observed that the effect of this declaration upon the determination of reimbursement levels for Medicare providers after June 30, 1981, "must be determined in the first instance by the Secretary and her delegates administering the claims procedures" (*id.* at 63a).

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[3] The Secretary did not argue that the annual cost limit schedule is not subject to APA notice and comment requirements and, accordingly, the district court did not address that issue. See Pet. App. 52a n.4. As a matter of internal policy, the Secretary has decided to adhere to APA notice and comment rulemaking procedures in promulgating provider reimbursement regulations under the Medicare Act, notwithstanding the exemption from those requirements under the APA for public property, loans, grants, benefits or contracts. See 5 U.S.C. 553(a)(2); 36 Fed. Reg. 2532 (1971); *Humana of South Carolina, Inc.* v. *Califano*, 590 F.2d 1070, 1082-1084 (D.C. Cir. 1978).

[4] Under 42 U.S.C. (& Supp. III) 1395*oo*(f)(1), a Medicare provider who is dissatisfied with the amount of reimbursement it has obtained may not seek judicial review until it has submitted its claim for additional compensation to the Provider Reimbursement Review Board. See *Bethesda Hosp. Ass'n* v. *Bowen*, No. 86-1764 (Apr. 4, 1988), slip op. 7-8.

Rather than appeal this decision, the Secretary elected to cure the procedural defect identified by the district court. In February 1984, the Secretary issued a notice of proposed rulemaking in which she proposed to reissue the 1981 wage indices and invited comment thereon. See 49 Fed. Reg. 6175. The notice stated that the indices set forth in the proposed rule would apply to cost reporting periods beginning on or after July 1, 1981 and ending after September 30, 1981, but would not apply to reporting periods beginning on or after October 1, 1982 (*ibid.*).[5] Thus, "the rule was to apply to cost accounting periods that would have been covered prospectively by the Secretary's 1981 rule had that rule been promulgated in accordance with the procedural requirements of the APA" (Pet. App. 9a).

The Secretary stated (49 Fed. Reg. 6177 (1984)) that

> the exclusion of Federal government hospital data would improve the accuracy of the wage index because most Federal hospitals characteristically employ physicians and other high salaried professionals whose salaries are based on national rather than local wage scales. This factor tends to overstate the average hospital wage in areas with Federal institutions as compared to areas without such Federal facilities. Since the purpose of the wage index is to reflect area-by-area differences in the labor-related component of hospital costs, the exclusion of Federal hospital data better enables the wage index to accurately reflect area-by-area labor-related costs.

The Secretary observed that where non-federal hospitals pay wages similar to those paid by the federal government, the data from non-federal hospitals would reflect those wages, and "the exclusion of Federal wages would have

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[5] Reimbursement of routine inpatient costs for those later cost periods is governed by different rules. See 49 Fed. Reg. 6175 (1984).

little effect on the wage index" (*ibid.*). If, on the other hand, "wages paid to Federal hospital employees are higher than most area hospital wage levels, then the inclusion of Federal data results in most hospitals receiving a higher Medicare cost limit than is warranted based on their expected costs. Such a result defeats the purpose of the cost limits, which is to limit a provider's reimbursement to only those costs necessary in the efficient delivery of needed health services." *Ibid.*

The Secretary stated that the reissuance of the 1981 wage indices, which had been calculated without wage data from federally-owned hospitals, "avoids placing an unwarranted hardship and burden on intermediaries and many hospitals, while it would impose only a minimal burden on a few hospitals" (49 Fed. Reg. 6177 (1984)). Because "[t]he inclusion of Federal data in the wage index at this point in time would result in overpayments to many hospitals," intermediaries might be forced to review already-settled cost reports and hospitals that had received excess reimbursement would be required to repay these sums to the government (*ibid.*). "In contrast, those few hospitals that would receive less reimbursement if Federal hospital data are excluded from the wage index would not be unduly harmed or burdened by the reissuance of the wage index," because those hospitals could only have relied on the wage indices published in 1981 (*ibid.*). "Since these limits are prospectively established and published in advance, all hospitals knew before the beginning of their respective cost reporting periods what their cost limit would be. * * * This proposed notice would simply put the previously set cost limits back into effect." *Ibid.*

After considering comments submitted by interested parties, the Secretary reaffirmed the propriety of the change in index methodology and reissued the 1981 wage indices in final form (49 Fed. Reg. 46495 (1984)). She rejected the contention that the application of the 1984 rule

to 1981 cost years constituted an impermissible retroactive rule, observing that "as a practical matter hospitals could only have relied on the [1981] rule in determining their respective cost limits" for the cost periods that would be covered by the 1984 rule (*id.* at 46497). Because "[e]ach hospital [therefore] knew in advance of its cost reporting period what its cost limit would be for this period," the Secretary concluded that the 1984 rule could properly be applied to 1981 cost reporting periods (*ibid.*).

2. Respondents are health care providers that stand to receive greater compensation if federal wage cost data were included in their wage cost index for 1981 than if federal data are excluded. After the Secretary reissued the original 1981 wage indices, respondents' fiscal intermediaries recouped funds previously reimbursed to respondents under wage indices that included federal hospital wage data. Respondents thereupon obtained the necessary certification from the Provider Reimbursement Review Board and commenced several actions in the United States District Court for the District of Columbia challenging the Secretary's decision to apply the revised index calculation methodology to their 1981 cost periods (see 42 U.S.C. (Supp. III) 1395*oo*(f)(1)). The district court consolidated the actions and entered judgment in favor of respondents. The court declined to address respondents' claims that the Secretary lacked the statutory authority to issue retroactive rules. Instead, the court held that the Secretary could not properly apply the 1981 wage indices retroactively on the facts of this case. See Pet. App. 20a-42a.

In so ruling, the district court applied the five-factor balancing test set forth in *Retail, Wholesale & Dep't Store Union* v. *NLRB*, 466 F.2d 380, 390 (D.C. Cir. 1972). The court concluded (Pet. App. 38a) that "the balancing of factors in this case compels the conclusion that Medicare statute interests are only minimally served, if at all, by

the Secretary's retroactive application of his reissued wage index to recoup funds from these plaintiffs. In contrast, the ill effects of the Secretary's actions are substantial for these plaintiffs and for the general integrity of the administrative rule-making process. Accordingly, retroactive application against these plaintiffs must be denied."

3. The court of appeals affirmed, but rested its decision upon grounds different from those adopted by the district court (Pet. App. 1a-19a). The court acknowledged that adjudicatory orders issued by administrative agencies may be given retroactive effect. But, citing the Administrative Procedure Act's definition of a "rule" as "an agency statement of general or particular applicability and *future effect*" (5 U.S.C. 551(4) (emphasis added)), the court concluded that "the APA requires that legislative rules be given future effect only. Because of this clear statutory command, equitable considerations are irrelevant to the determination of whether the Secretary's rule may be applied retroactively; such retroactive application is foreclosed by the express terms of the APA" (Pet. App. 13a; see *id.* at 11a-12a).

The court stated that when the district court invalidated the 1981 rule, "it necessarily reinstated the Secretary's *1979* rule, which required the Secretary to reimburse providers using a formula that included federal-hospital data" (Pet. App. 13a (emphasis in original)). "The Secretary's 1984 rule obviously can have no application to cost accounting periods that were, by virtue of the District Court's ruling, governed by the Secretary's 1979 rule" (*ibid.*). In the court's view, "agencies would be free to violate the rulemaking requirements of the APA with impunity if, upon invalidation of a rule, they were free to 'reissue' that rule on a retroactive basis" (*id.* at 14a). The court acknowledged that if an agency rule is invalidated on procedural grounds, "the agency must, of course, be given an opportunity to correct the procedural defect and promulgate a new rule"; but "the corrected rule, like all other legislative rules, [must] be prospective in effect only" (*ibid.*).[6]

The court of appeals acknowledged that Congress may "override the general terms of the APA by explicitly authorizing retroactive regulations in an agency's organic statute" (Pet. App. 14a). The court of appeals, however, rejected petitioner's contention that the retroactive 1984 regulation was specifically authorized by Section 1861(v)(1)(A)(ii) of the Medicare Act, 42 U.S.C. (Supp. III) 1395x(v)(1)(A)(ii), which empowers the Secretary of Health and Human Services to issue "regulations" that "provide for the making of suitable retroactive corrective adjustments where * * * the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive." According to the court of appeals, the Secretary could not rely on the retroactive adjustments provision to support the 1984 rule because the provision was not explicitly cited by the agency in promulgating that rule (Pet. App. 16a). The court stated that "[i]t was not until the litigation in the District Court that the Secretary sought to invoke the retroactive adjustments provision as authority for the rule" (*ibid.*).

In any event, the court held, "Congress did *not* intend to empower the Secretary to promulgate retroactive cost-limit rules" (Pet. App. 15a (emphasis in original)). The court discerned "a critical distinction between the power to promulgate retroactive rules of general application and the power to make retroactive corrective adjustments in the

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[6] In its order denying the petition for rehearing, the court of appeals stated that "[a]s a general rule, the APA requires that legislative rules be given future effect only. Whatever exceptions might exist to this general rule were not implicated in the case before us. Our opinion therefore does not purport to address circumstances in which there may be an exception to the rule against retroactive rulemaking." Pet. App. 45a.

reimbursements of particular providers whose aggregate reimbursements are shown to be either 'inadequate or excessive' " in case-by-case evidentiary proceedings (*id.* at 17a). It concluded that Section 1861(v)(1)(A)(ii) confers only the latter power upon the Secretary, authorizing him to make retroactive adjustments to individual reimbursement determinations where he is able to "prove that inadequate or excessive reimbursements to a provider have resulted from his 'methods of determining costs' " (Pet. App. 18a (citation omitted)). Where, as in this case, there is no individualized proof that the reimbursement awarded respondents exceeded their reasonable costs, the court held that the Secretary has no authority to adjust those reimbursement awards retroactively (*id.* at 18a-19a).

SUMMARY OF ARGUMENT

A. The court of appeals' decision in this case rests on two untenable propositions: (1) that a court order invalidating an agency rule on procedural grounds automatically reinstates the agency's prior rule and thereby precludes any subsequent retroactive rulemaking; and (2) that a "retroactive application [of agency rules] is foreclosed by the express terms of the APA" (Pet. App. 13a). Both propositions are inconsistent with established tenets of federal administrative law.

When a reviewing court sets aside an agency rule because of a procedural violation, the court's order does not finally determine what rule should apply. Such an order simply rejects one attempt by the agency to answer that question and does not deprive the agency of its congressionally-delegated responsibility to reexamine the issue on remand. Indeed, an agency's authority to engage in curative rulemaking is well-settled.

Moreover, neither the APA's definition of "rule" nor its legislative history supports the court's and respondents'

view that the APA bars retroactive rulemaking. The reference to "future effect" in the definition of "rule" merely expresses the notion that a rule is a statement of law or policy that is not applied in the same proceeding in which it is announced; any application or enforcement will occur *only in the future*. Indeed, the legislative history reveals that Congress understood that the "future effect" of a rule might well include an effect on past transactions and that Congress considered, and rejected, the very prohibition on retroactive rulemaking that respondents and the court of appeals now read into the APA.

Nor does the Medicare Act itself specifically prohibit the Secretary from promulgating retroactive cost limit rules following judicial invalidation of cost limit rules previously proposed by the Secretary. The provision of the statute authorizing the Secretary to adopt cost limit rules, which was enacted in 1972, does not speak to this question. Although the legislative history reflects Congress's understanding that cost limit rules would generally operate prospectively, there is no suggestion that Congress intended to curb the Secretary's discretion to promulgate retroactive rules where a court has invalidated the Secretary's previous rules because of procedural violations.

In our view, the Secretary has general rulemaking authority under the Medicare Act to promulgate a retroactive cost limit rule so long as his decision is not arbitrary, capricious, an abuse of discretion, or otherwise contrary to law. Where, as in this case, the retroactive regulation is "curative" in character—that is, it merely cures a procedural error in a prior rule without changing its substance—then the element of unfair surprise often associated with retroactive lawmaking is simply not present. Respondents had adequate notice that the reasonableness of their costs would be assessed against the substantive standard of the 1984 rule because that rule simply

adopted the same standard as the 1981 rule, which was in place when respondents incurred their costs. On the other hand, if the retroactive cost limit is not upheld, respondents will receive a windfall at the taxpayers' expense. Thus, there can be no contention that the Secretary's decision to issue a retroactive rule is arbitrary and capricious.

B. The decision of the court of appeals is also wrong because, wholly apart from the Secretary's general rulemaking authority under the Medicare Act, the Secretary has properly construed Section 1861(v)(1)(A)(ii) of the Medicare Act as authorizing retroactive regulations establishing a cost limit ceiling. Section 1861(v)(1)(A)(ii) allows the Secretary to promulgate "regulations * * * for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive." In this case, the prior (1979) cost limit rule constitutes "the method[] of determining costs" that the Secretary has deemed to cause "excessive" reimbursement, and the retroactive regulation challenged in this case is for the express purpose of making a "retroactive corrective adjustment[]" in such reimbursement. Because the statutory language "admits of" the Secretary's construction, which is not contradicted by the legislative history and which offers a sensible implementation of Congress's purpose, it must be upheld. See *Young* v. *Community Nutrition Inst.*, 476 U.S. 974, 981 (1986); *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. 837, 842-844 (1984).

ARGUMENT

I. NEITHER THE ADMINISTRATIVE PROCEDURE ACT NOR THE MEDICARE ACT BARS THE SECRETARY OF HEALTH AND HUMAN SERVICES FROM PROMULGATING A RETROACTIVE COST LIMIT RULE PURSUANT TO HIS GENERAL RULEMAKING AUTHORITY UNDER THE MEDICARE ACT

The Secretary's 1984 cost limit rule is a valid exercise of his general rulemaking authority under the Medicare Act. See 42 U.S.C. (& Supp. III) 1395x(v)(1)(A), 1395hh, 1395ii. Respondents appear to argue (see Br. in Opp. 5-6) that the effect of the 1983 district court order, which invalidated the Secretary's 1981 rule (see Pet. App. 49a-64a), was to reinstate the agency rule that predated the invalidated rule. For this reason, they suggest, the Secretary lacked authority on remand to promulgate a new retroactive rule. Respondents further contend that retroactive cost limit rules are barred by the APA's definition of a rule and by the legislative history of the 1972 amendments to the Medicare Act. Each of these claims is without foundation.

A. The District Court's 1983 Order, Which Invalidated the Secretary's 1981 Rule, Did not Reinstate the Secretary's Prior 1979 Rule so as to Prohibit, on Remand, the Secretary's Promulgation in 1984 of a Retroactive Rule

Respondents contend that the Secretary's failure to appeal the district court's invalidation of its 1981 rule reinstated the Secretary's prior 1979 rule and precluded any subsequent retroactive rulemaking. Respondents, however, fundamentally misapprehend the scope of an agency's authority on remand from a court order invalidating an agency rule on procedural grounds. They also ignore the traditional role of curative rulemaking.

1. Contrary to respondents' contention (Br. in Opp. 5-6; see also Pet. App. 13a), a decision by a reviewing court

setting aside an agency rule because of procedural irregularities does not finally decide the question what rule should apply. It merely rejects one attempt by the agency to answer that question. On remand, the agency retains authority "to deal with the problem afresh, performing the function delegated to it by Congress"; the fact that the agency committed a procedural error in its prior endeavor does not confer on anyone a "vested right" in any particular regulatory outcome on remand. *SEC* v. *Chenery Corp.*, 332 U.S. 194, 200-201 (1947);[7] see *Burlington Northern Inc.* v. *United States*, 459 U.S. 131, 142 (1982); *NLRB* v. *Food Store Employees Union, Local 347*, 417 U.S. 1, 10 (1974); *FPC* v. *Idaho Power Co.*, 344 U.S. 17, 20 (1952); *Addison* v. *Holly Hill Fruit Products, Inc.*, 322 U.S. 607, 619-622 (1944); see also *Motor Vehicle Mfrs. Ass'n of the United States* v. *State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 57 & n.21 (1983).

Respondents' contention is not only contrary to well-established tenets of administrative law, it is also unworkable. If an order of a reviewing court setting aside an agency rule on procedural grounds reinstates the agency's prior rule, and precludes further attempts by the agency to

[7] Respondents' argument is identical to the argument that this Court rejected in *Chenery*. Previously, in *SEC* v. *Chenery Corp.*, 318 U.S. 80 (1943), the Court set aside as inadequately justified an order of the Securities and Exchange Commission and had directed that the case be remanded to the Commission for futher proceedings. Upon reexamining the problem, the Commission reached the same result. In rejecting respondents' claim that the Court's initial decision precluded the Commission's decision, the Court stated that its prior decision held "no more and no less than that the Commission's first order was unsupportable for the reasons supplied by that agency" (332 U.S. at 200). The Court explained that "[t]he fact that the Commission had committed a legal error in its first disposition of the case certainly gave [the respondents] no vested right" and on remand "therefore, the Commission was bound to deal with the problem afresh, performing the function delegated to it by Congress" (*id.* at 200-201).

modify the prior rule other than prospectively, the result would be that the *court* rather than the agency would have determined agency policies for the period covered by the procedurally-flawed rule. Such a result is particularly anomalous in that the reinstated rule is one that the agency has already found to be unsatisfactory and which, indeed, may even be contrary to intervening statutory provisions. Moreover, this result would force agencies to seek review of many more lower court decisions invalidating regulations because of procedural defects in order to protect their regulatory authority. There is no warrant for this kind of judicial intrusion into agency policymaking prerogatives. An agency should be permitted to exercise its discretion following a remand to determine in the first instance the suitable course of action. Cf. *Vermont Yankee Nuclear Power Corp.* v. *NRDC, Inc.*, 435 U.S. 519 (1978) (holding that a court may not impose procedural requirements on an agency on remand beyond those required by statute).

Accordingly, the district court's 1983 order invalidating the Secretary's 1981 rule did not finally decide the question of the appropriate standard to be applied in calculating the wage cost reimbursement owed to respondents under the Medicare program. The court's order simply rejected—on procedural grounds—one answer to that question. The Secretary therefore retained his authority "to deal with the problem afresh, performing the function delegated to [him] by Congress" (*SEC* v. *Chenery Corp.*, 332 U.S. at 200-201).[8] He was not required to appeal the 1983 district

[8] The district court refused to issue an order barring the Secretary from applying the 1981 rule to respondents' reimbursement claims, holding that the provisions of the Medicare statute requiring exhaustion of administrative remedies deprived the court of authority to issue such an order. The court expressly stated that respondents' claims were left to be adjudicated in the administrative process. See Pet. App. 62a-64a.

court order to preserve his authority to promulgate the same rule after correcting the procedural error.

Nor is there any merit to respondents' claim (Br. in Opp. 8), that this deprives them of the "fruits of their victory." Respondents did not challenge the substance of the 1981 rule (see Pet. App. 51a), which was set aside solely because of procedural deficiencies. Consequently, the only "fruit" to which respondents are entitled is notice and an opportunity to comment as provided by 5 U.S.C. 553—which they in fact received on remand. Respondents cannot convert an exclusively procedural victory into a substantive victory on the merits that entitles them, in contravention of Congress's mandate, to reimbursement for costs inefficently incurred.

2. In addition, contrary to respondents' claim (Br. in Opp. 7), the Secretary's 1984 rule does not make "a mockery of" administrative procedure by reenacting without substantive change the Secretary's 1981 rule. There is nothing inherently suspect or improper about such a procedure. Quite the opposite is true; courts have long upheld similar exercises in "curative" lawmaking because they do *not* raise any of the problems of inadequate notice generally associated with retroactive rules.

As this Court observed in *Graham & Foster* v. *Goodcell*, 282 U.S. 409, 429 (1931), which concerned the analogous question of the validity of curative legislation, a distinction must be drawn "between a bare attempt of the legislature retroactively to create liabilities for transactions * * * fully consummated in the past * * * and the case of a curative statute aptly designed to remedy mistakes and defects in the administration of government where the remedy can be applied without injustice." Curative acts "impair[] no substantial right or equity" and are "free of the elements of novelty and surprise which have led to condemnation, as unreasonable and arbitrary, of other retroactive legislation." *Swayne & Hoyt, Ltd.* v. *United States*,

300 U.S. 297, 302 (1937); see *Forbes Pioneer Boat Line* v. *Board of Comm'rs*, 258 U.S. 338 (1922); *United States* v. *Heinszen & Co.*, 206 U.S. 370 (1907); see also *Van Emmerik* v. *Janklow*, 454 U.S. 1131 (1982) (White & Blackmun, JJ., dissenting from dismissal of appeal). "It is when things go wrong that the retroactive statute often becomes indispensable as a curative measure; though the proper movement of law is forward in time, we sometimes have to stop and turn about to pick up the pieces." L. Fuller, *The Morality of Law* 53 (rev. ed. 1969).[9]

For similar reasons, "[t]he retroactive curing, without change of content, of a defective regulation seems the least objectionable application of administrative retroactivity." Note, *Retroactive Operation of Administrative Regulations*, 60 Harv. L. Rev. 627, 628 (1947); cf. *Holly Hill Fruit Products, Inc.*, 322 U.S. at 621. The circumstances of this case well illustrate why curative retroactive rules do not raise the same concerns about prejudice and unfair surprise associated with other forms of retroactive rules. The wage indices at issue here were initially promulgated as an entirely prospective regulation issued in 1981. When

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[9] See generally, Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 Harv. L. Rev. 692, 705-706 (1960) (quoting *Danforth* v. *Groton Water Co.*, 178 Mass. 472, 477, 59 N.E. 1033, 1034 (1901)) ("The Court's favorable treatment of curative statues is probably explained by the strong public interest in the smooth functioning of government. It is necessary that the legislature should be able to cure inadvertent defects in statutes or their administration by making what has been aptly called 'small repairs.' Moreover, the individual who claims that a vested right has arisen from the defect is seeking a windfall since, had the legislature's or administrator's action had the effect it was intended to and could have had, no such right would have arisen."); Slawson, *Constitutional and Legislative Considerations in Retroactive Lawmaking*, 48 Cal. L. Rev. 216, 239 (1960); Munzer, *A Theory of Retroactive Legislation*, 61 Tex. L. Rev. 425, 470 (1982); W. Gellhorn, *Administrative Law* 300-301 (1940).

that regulation was invalidated by the district court on procedural grounds in 1983, the Secretary decided not to appeal that determination; instead—after subjecting the regulation to prior notice and comment—she reissued the 1981 regulation in 1984. Because the 1984 regulation adopted the identical substantive standard as had been adopted in 1981, all hospitals affected by the 1984 rule—including respondents—were plainly on notice before they incurred the costs subject to the 1984 rule that the reasonableness of those costs would be measured against the standards contained in that rule. No serious hardship therefore results from the 1984 retroactive rule. To the contrary, because more hospitals are benefited by the rule than are burdened, a hardship would result absent retroactivity. See 49 Fed. Reg. 6177 (1984).

3. Finally, there is no merit to the court of appeals' assertion that "agencies would be free to violate the rulemaking requirements of the APA with impunity if, upon invalidation of a rule [based on a procedural defect], they were free to 'reissue' that rule on a retroactive basis" (Pet. App. 14a). A decision by a reviewing court invalidating a rule for failure to conform to the procedural requirements of the APA means, at the very least, that the agency must follow those procedures before it repromulgates its rules. By affording the required procedures on remand the agency has not violated the law "with impunity"—it has *corrected* the legal error.

Moreover when an agency is required to conduct new rulemaking proceedings that are free from procedural defects, it must consider any information obtained during those proceedings, and respond to significant comments made. See *State Farm Mutual Auto. Ins. Co.*, 463 U.S. at 43. The agency may be persuaded by such comments to adopt a different rule. Or, it may decide, based on the new

administrative record generated by those proceedings, to adopt the same substantive rule. In either event, its decision will be subject to further review under the arbitrary and capricious standard of the APA. See 5 U.S.C. 706(2)(A). Moreover, where the agency decides, as the Secretary did here, to apply the new rule retroactively, it must defend its decision to do so under that same standard of review. As discussed (pages 36-40, *infra*), the Secretary's decision to adopt a retroactive rule in 1984 was not arbitrary and capricious.

B. The Administrative Procedure Act Does not Bar Retroactive Regulations

Congress passed the APA in 1946, over 40 years ago. Until the court of appeals' decision in this case, however, no court appears to have construed the APA to impose what amounts to a complete ban on retroactive rules, including the promulgation of curative regulations, such as those challenged in this case.[10] Courts[11] and com-

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[10] The court of appeals initially stated that all retroactive rules were prohibited by the APA (Pet. App. 13a). In its order denying the petition for rehearing, the court indicated that there might be some exceptions to this "general rule," but declined to state what those exceptions might be (*id.* at 45a). That vague order does nothing to eliminate the fundamental error in the court's legal analysis—the conclusion that the APA's definition of a "rule" imposes an independent limitation upon retroactive rulemaking.

[11] See, *e.g.*, *Texaco, Inc.* v. *Department of Energy*, 795 F.2d 1021, 1025-1027 (Temp. Emer. Ct. App.), cert. dismissed, 478 U.S. 1030 (1986); *Daughters of Miriam Center for the Aged* v. *Mathews*, 590 F.2d 1250, 1259-1260 (3d Cir. 1978) (interpretative rule); *National Helium Corp.* v. *FEA*, 569 F.2d 1137, 1145 n.18 (Temp. Emer. Ct. App. 1977); see also *National Ass'n of Indep. Television Producers & Distributors* v. *FCC*, 502 F.2d 249, 255 nn.10 & 11 (2d Cir. 1974); *General Telephone Co.* v. *United States*, 449 F.2d 846, 863 (5th Cir. 1971); cf. *Illinois* v. *Bowen*, 786 F.2d 288, 292-293 (7th Cir. 1986) (retroactive application of a new interpretation of an administrative

mentators[12] alike have instead generally expressed the view—which is consistent with principles of administrative law pre-dating the APA[13]—that agencies may promulgate

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regulation). Even prior decisions of the District of Columbia Circuit were to the same effect. See *Citizens To Save Spencer County* v. *EPA*, 600 F.2d 844, 879-881 (1979); see also *Maxcell Telecom Plus, Inc.* v. *FCC*, 815 F.2d 1551, 1554-1556 (1987).

[12] See, *e.g.*, 2 K. Davis, *Administrative Law* § 7.23, at 109 (2d ed. 1979) ("[R]etroactive rules are valid if they are reasonable but are invalid if their retroactivity is unreasonable in the circumstances."); Davis, *Administrative Rules—Interpretative, Legislative, and Retroactive*, 57 Yale L.J. 919, 921 (1948); F. Cooper, *Administrative Agencies and the Courts* 285 (1951) ("If it is a legislative regulation, it is normally competent for the agency to amend its regulation, just as it is proper for a legislature to amend a statute; and there is normally nothing to prevent the amended regulation being applied in situations where it has retroactive effects.").

[13] See, *e.g.*, *Addison* v. *Holly Hill Fruit Products, Inc.*, *supra*; *Porter* v. *Senderowitz*, 158 F.2d 435 (3d Cir. 1946) (retroactive price order), cert. denied, 330 U.S. 848 (1947); 1 F. Vom Baur, *Federal Administrative Law* § 493, at 491 (1942) (footnote omitted) ("In general, an administrative regulation may not be applied retroactively. However, where an original regulation is invalid because not consistent with the statute or unreasonable, a valid amended regulation becomes the primary and controlling rule in respect of the situation presented, even as to past transactions."); Lee, *Legislative and Interpretative Regulations*, 29 Geo. L.J. 1, 29 (1940) (footnote omitted) ("The administrative officer or agency should be able to amend its prior legislative regulation just as Congress may amend its prior legislation. As a matter of law it should even be possible to do this with retroactive effect subject to the limits of the Fifth Amendment due process clause on retroactive legislation and to the limitations, if any, expressed or implied in the particular statutory grant of the power to prescribe legislative regulations."); see also *Miller* v. *United States*, 294 U.S. 435, 439 (1935); *Twin City Milk Producers Ass'n* v. *McNutt*, 123 F.2d 396, 398 (8th Cir. 1941) (see *Twin City Milk Producers Ass'n* v. *McNutt*, 122 F.2d 564 (8th Cir. 1941)).

This Court's decision in *Arizona Grocery Co.* v. *Atchison, T. & S.F. Ry.*, 284 U.S. 370 (1932) is not to the contrary. The Court ruled

retroactive rules so long as their retroactive effect is reasonable and not otherwise barred by law. Cf. *Heckler* v. *Community Health Services*, 467 U.S. 51, 60 n.12 (1984) ("an administrative agency may not apply a new rule retroactively when to do so would unduly intrude upon reasonable reliance interests"). Nothing in the language, structure, or legislative history of the APA supports the contrary view urged by respondents and embraced by the court of appeals.

1. The APA defines "rule" as "an agency statement of general or particular applicability and future effect" (5 U.S.C. 551(4)). Contrary to the court of appeals' ruling, however, the inclusion of the words "future effect" in this definition does not bar retroactive rulemaking. The "future effect" of a rule, in the context of Section 551(4),

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in that case that the Interstate Commerce Commission, having prescribed a maximum reasonable rate, "may not at a later time, and upon the same or additional evidence as to the fact situation existing when its previous order was promulgated, by declaring its own finding as to reasonableness erroneous, subject a carrier which conformed thereto to the payment of reparation measured by what the Commission now holds it should have decided in the earlier proceeding to be a reasonable rate" (*id.* at 390). The Court's ruling, however, did not depend on the general principle that rules can operate only prospectively. Rather, the Court indicated that under the facts of that case, the Commission, like "the legislature itself," could not "substitute a new rule of conduct" to govern the past transaction (*id.* at 389). Hence, the Court's ruling appears to rest on constitutional considerations.

Whether or not the Court's intimation in *Arizona Grocery* that Congress would have been without constitutional authority to enact a retroactive order accurately reflected constitutional doctrine at that time, this Court's jurisprudence has since clearly evolved. See, *e.g.*, *Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976). But in any event, the type of concerns raised in *Arizona Grocery*, where the federal agency dramatically changed the *substance* of a prior, specifically-drawn rule and applied its new rule retroactively, is plainly not implicated here, where the Secretary merely promulgated a curative rule that did not differ substantively from his earlier (1981) rule.

refers simply to *when* a rule applies, not to *what* transactions, whether past or present, it applies. A rule does not govern anything until it is legally "effective." Hence, a rule may, as in this case, be effective in the future, yet, once effective, concern transactions that were completed prior to its effective date. See 49 Fed. Reg. 46495 (J.A. 29).[14]

The reference to "future effect" therefore serves simply to distinguish rulemaking from adjudication, not to prohibit retroactive regulations as a matter of law. In this respect, the APA adheres to the traditional view, which is that a legislative "rule" is a statement of law or policy that is not applied or enforced in the same proceeding in which it is announced; any application or enforcement occurs *only in the future, i.e.,* in an adjudication. Cf. J. Dickinson, *Administrative Justice and the Supremacy of Law* 21 (1927) (emphasis added) ("What distinguishes legislation from adjudication is that the former * * * *must be applied in a further proceeding* before the legal position of any particular individual will be definitely touched by it * * *."); *id.* at 15 n.25 (emphasis added) (administrative regulations "lay down general rules and leave them to be applied *in a later proceeding* to the facts of particular cases"); see also Davis, *supra,* 57 Yale L.J. at 921.

The structure of the APA supports this view. Section 553(d) shows that Congress was aware of the distinction between when a rule is effective and whether a rule, once

[14] See Shapiro, *The Choice of Rulemaking or Adjudication in the Development of Administrative Policy,* 78 Harv. L. Rev. 921, 953 (1965) (footnotes omitted) ("Section 2(c) of the [APA] defines a 'rule' as any agency statement of 'future effect,' but this provision has never specifically been held to preclude a regulation from having a retrospective effect or from upsetting reliance interests based on prior policy. Nor is the provision of section 4(c), stating that certain regulations cannot take effect in less than thirty days after publication, controlling. * * * [T]he effective date of a regulation does not necessarily govern its impact.").

effective, applies to past or present transactions. It also shows that Congress spoke only to the first issue in the APA. Section 553(d) provides that "[t]he required publication or service of a substantive rule shall be made not less than 30 days before its effective date" except in certain specified circumstances.[15] Congress's intention in Section 553(d) to ensure a future "effective date" for agency rules is consistent with its defining a rule in terms of its "future effect" in Section 551(4). Neither statutory provision touches on the question whether a rule, once effective, may govern past transactions or events.[16]

2. The legislative history also refutes respondents' proposed construction of the APA. It shows that Congress considered and rejected proposals to ban retroactive regulations, possibly out of concern that such a ban would be overly broad and would call into question the propriety of the very type of curative rulemaking engaged in by HHS in this case. In addition, the legislative history of Congress's adoption of the "future effect" language in the definition of a rule makes clear that Congress did not equate that language with the absence of retroactivity.

[15] The requirement of a 30-day delay in effectiveness does not apply to: "(1) a substantive rule which grants or recognizes an exemption or relieves a restriction; (2) interpretative rules and statements of policy; or (3) as otherwise provided by the agency for good cause found and published with the rule" (5 U.S.C. 553(d)).

[16] The statutory context of the "future effect" language upon which respondents rely likewise renders their interpretation of the APA implausible. The relevant provision, Section 551(4), is part of an introductory provision defining the Act's terms, including the meaning of "rule." For that reason, Section 551(4) cannot fairly be characterized as prohibiting rules without "future effect"; at most, the provision would, under respondents' reading, express congressional intent that a statement of agency policy or law lacking in future effect is not a "rule," within the meaning of the APA. In no event therefore does Section 551(4) support the court of appeals' much broader ruling that the APA bars regulations that operate retroactively.

a. The enactment of the APA in 1946 was the culmination of over eight years of careful study and debate involving the Congress, Executive Branch, and private bar. See generally *Wong Yang Sung* v. *McGrath,* 339 U.S. 33, 36-41 (1950); H.R. Rep. 1980, 79th Cong., 2d Sess. 6-15 (1946), *reprinted in* Senate Comm. on the Judiciary, 79th Cong., 2d Sess., *Administrative Procedure Act—Legislative History* 233, 241-250 (1946) [hereinafter *APA Leg. Hist.*]; *Attorney General's Manual on the Administrative Procedure Act* 5-7 (1947) [hereinafter *Attorney General's Manual*]. The Senate and House held lengthy hearings on proposed legislation.[17] A Committee appointed by the Attorney General undertook an in-depth study of federal administrative law, which resulted in the publication of a final Committee Report along with 27 monographs on the practices of various administrative agencies.[18] And the American Bar Association (ABA) and the National Conference of Commissioners on Uniform State Laws each debated and developed their own proposed model federal administrative procedure acts.[19]

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[17] See *Administrative Law: Hearings Before Subcomm. No. 4 of the House Comm. on the Judiciary,* 76th Cong., 1st Sess. (1939); *Administrative Procedure: Hearings Before A Subcomm. of the Senate Comm. on the Judiciary,* 77th Cong., 1st Sess. Pts. 1-4 (1941); *Administrative Procedure: Hearings Before the House Comm. on the Judiciary,* 79th Cong., 1st Sess. (1945) [hereinafter *1945 House Hearings*].

[18] See *Administrative Procedure in Government Agencies,* S. Doc. 186, 76th Cong., 3d Sess. Pts. 1-13 (1940) (monograph of the Attorney General's Committee on Administrative Procedure); *Administrative Procedure in Government Agencies,* S. Doc. 10, 77th Cong., 1st Sess. Pts. 1-14 (1941) (same); *Administrative Procedure in Government Agencies,* S. Doc. 8, 77th Cong., 1st Sess. (1941) (Report of the Attorney General's Committee).

[19] See Commentaries, 30 A.B.A. J. 6-7, 181, 185-193, 226-229 (1944); *Handbook of the National Conference of Commissioners on Uniform State Laws* 226-231 (1943) [hereinafter *1943 Handbook*];

In the course of these exhaustive deliberations, Congress did not overlook the issue of retroactive rules. Indeed, several congressmen and the ABA proposed that retroactive rules should be expressly barred except in limited circumstances. Significantly, the wording of their proposals confirms that those in Congress who wished to prohibit retroactive rules understood the difference between retroactivity and legal effectiveness, and accordingly took care specifically to proscribe the former and to require that the latter did not occur until after publication of the rule. Their bills typically provided that "[n]o rule or order shall be retroactive *or* effective prior to its publication or service unless such effect is both expressly authorized by law and required for good cause." H.R. 5237, 78th Cong., 2d Sess. § 5(e) (1944) (emphasis added); H.R. 339, 79th Cong., 1st Sess. § 5(e) (1946) (same); H.R. 1117, 79th Cong., 1st Sess. § 5(e) (1946) (same); S. 2030, 78th Cong., 2d Sess. § 5(e) (1944) (same except no "expressly"); H.R. 5081, 78th Cong., 2d Sess. § 5(e) (1944) (no "expressly"); see Commentary, 30 A.B.A. J. 229 (1944) (no "expressly").

Congress, however, omitted any reference to "retroactive" rules in the version ultimately enacted. As described above, Section 553(d) provides only that a legislative rule is, except in limited circumstances, not legally "effective" until 30 days after its publication in the Federal Register. Congress's deliberate omission of the reference to retroactive rules is strong, if not dispositive, evidence that it did not intend to bar retroactive rulemaking in the APA. Cf. *Bowen* v. *Galbreath,* No. 86-1146 (Feb. 24, 1988), slip op. 3.

Moreover, there is reason to believe that Congress understood that, absent such an explicit statutory prohibi-

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Handbook of the National Conference of Commissioners on Uniform State Laws 106-109, 329 (1944) [hereinafter *1944 Handbook*].

tion, agencies would have the power to promulgate retroactive rules in appropriate cases. Courts and commentators alike then recognized that agencies had the authority to promulgate retroactive rules (see note 13, *supra*) Indeed, in 1944, during congressional consideration of the APA, this Court held that a federal agency should engage in retroactive rulemaking. See *Addison* v. *Holly Hill Fruit Products, Inc., supra.*[20]

Finally, the legislative history suggests that Congress was advised of the need for curative regulations of the type at issue in this case and may have declined, for that very reason, to bar retroactive rules. During the final House hearings in 1945 on six pending bills, two of which generally barred retroactive rules (see H.R. 339, *supra*; H.R. 1117, *supra*), Representative Gwynne questioned Carl McFarland, former member of the Attorney General's Committee and then-Chairman of the ABA committee on administrative law concerning the impact of the pending proposals on retroactive rules:

> McFarland: Now there is another point that seems to be fairly well agreed upon * * * and that is the rules of an agency, before finally going into effect, should be deferred for, say 30 days * * *.
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> * * * * *

[20] In *Addison* v. *Holly Hill Fruit Products, Inc.*, the Court invalidated a rule promulgated by the Administrator of the Department of Labor's Wage and Hour Division, and remanded the case to the district court with instructions to allow the Administrator to promulgate a new rule retrospectively (see 322 U.S. at 619). The Court reasoned that such a disposition was most "consonant with justice," "law," and "logic" (*ibid.*). The Court never doubted that the Administrator had authority to promulgate a retroactive rule "within the authority given him by Congress" (*id.* at 619, 621), and specifically relied on its own precedent upholding curative laws (*id.* at 622).

> Rep. Gwynne: What about the retroactive effect of regulations?
>
> McFarland: That is quite a subject in itself.
>
> Rep. Gwynne: Do these bills provide that the individual is protected against that?
>
> McFarland: Yes; there is provision respecting that in one or two of the bills. In connection with retroactivity, there are various problems. One is the retroactivity of curative regulations.

1945 House Hearings 32, *reprinted in APA Leg. Hist.* 76, 78.

The exchange is significant in several respects. First, it provides further evidence of a common understanding among those involved in the APA's enactment that future legal effectiveness is not equivalent to a prohibition on retroactive rules. While McFarland stated that there was general consensus regarding the propriety of the former, the retroactivity issue was, by contrast, "quite a subject in itself." Second, the discussion confirms that only those two bills that expressly barred retroactive rules, neither of which were ultimately enacted, actually limited retroactive rules. Finally, the discussion provides at least some evidence that members of Congress had been advised that the need for "curative regulations" presented a "problem[]" for any ban on retroactive rules. This suggests the possibility that Congress ultimately rejected a ban at least partly for that very reason.[21]

Likewise relying on cases involving curative laws, even those dissenting from the Court's disposition of the case in *Addison* agreed that there may be occasion when "corrective needs may prompt and vindicate a grant of such authority" (*id.* at 641 (Rutledge, J., dissenting)).

[21] In earlier Senate Hearings, the General Counsel of the Railroad Retirement Board also advised Congress concerning the need for retroactive rules in certain circumstances. See *1941 Senate Hearings* Pt. 2, at 540 (testimony of Lester P. Schoene).

b. The legislative history of Congress's inclusion of the phrase "future effect" in the APA's definition of "rule" is likewise consistent with our reading of the law. It shows that the language was added merely for purposes of clarification and not for the purpose of making any substantive change in the law. Congress, in effect, intended to codify, not depart from, the traditional meaning of an agency "rule."[22] A prohibition on retroactive rules, however, would have been just such a major departure from settled law and agency practice.

The phrase "future effect" first appeared in the language of the bill reported by the House Judiciary Committee in 1946, which both chambers subsequently passed. None of the prior bills had referred to "future effect" in defining "rule." Proposals for legislation had instead invariably defined a "rule" as an agency statement of "general application," consistent with then-recent congressional enactments and the views of prominent commentators. Compare, *e.g.*, S. 674, 77th Cong., 1st Sess. § 102(c) (1941) ("of general application"), *reprinted in 1941 Senate Hearings* Pt. 1, at 3, and H.R. 339, *supra*, § 1 ("of general applicability"), *reprinted in 1945 House Hearings* 139, with Federal Register Act, ch. 417, § 5, 49 Stat. 501 ("general applicability and legal effect") and Fuchs, *Procedure in Administrative Rule-Making*, 52 Harv. L. Rev. 259, 265 (1938) ("[I]t is useful to define rule-making as the issuance of regulations or the making of determinations which are addressed to indicated but unnamed and unspecified persons or situations * * *.").

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[22] See Davis, *supra*, 57 Yale L.J. at 926 ("The traditional meaning of the word 'rule' remains, and is clarified by the specific language of [the APA] * * *. The overall result is that 'rule' still has about the same meaning as it did before the Act, except that the Act clarifies some points that were doubtful."). See note 13, *supra*.

Although the definition of "rule" in pending legislative proposals maintained its focus on "general applicability" through March 1946, when the Senate initially passed the legislation, the Senate did make one change in wording. In response to the concern expressed during House hearings and in agency comments that the requirement of "general applicability" would improperly place certain proceedings—such as rate determinations by the Interstate Commerce Commission—outside the definition of agency "rulemaking," the Senate Judiciary Committee amended the definition of "rulemaking" to include "any prescription for the future of rates, wages, financial structures" (S. Rep. 752, 79th Cong., 1st Sess. 11 (1945), *reprinted in APA Leg. Hist.* 197; see Senate Comm. on the Judiciary, 79th Cong., 1st Sess. (Comm. Print 1945), excerpt *reprinted in APA Leg. Hist.* 14; *1945 House Hearings* 77-80, *reprinted in APA Leg. Hist.* 123-126).

The House Judiciary Committee accepted the language added by the Senate (shifting it, however, to the definition of "rule") and added more language to the same effect, including the requirement of "future effect." In particular, the House Committee modified the definition of "rule" to state that a rule has "general or particular applicability and future effect." H.R. Rep. 1980, 79th Cong., 2d Sess. 2, 19-20, 49 & n.1 (1946), *reprinted in APA Leg. Hist.* 236, 254, 283 & n.1).[23] The accompanying House Report leaves

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[23] The additional words "particular" and "future effect" seem to have had their genesis in two different sources. The House appears to have adopted "particular" from the Senate Report's explanation of its inclusion of specific language designed to bring ratemaking proceedings within the "rulemaking" defintion. See S. Rep. 752, *supra*, at 11, *reprinted in APA Leg. Hist.* 197 (emphasis added) ("The specification of the activities that are involved in rule making is included in order to comprehend them beyond any possible question. They are defined as rules to the extent that, *whether of general or particular applicability*, they formally prescribe a course of conduct for the future rather

no doubt that the words "future effect" pertained to the legal effectiveness of a rule and application in a further proceeding and did not proscribe the imposition of retroactive regulations when otherwise in accordance with law. The Report explains that "[t]he phrase 'future effect' does not preclude agencies from considering, and so far as legally authorized, dealing with past transactions in prescribing rules for the future" (H.R. Rep. 1980, *supra,* at 49 n.1, *reprinted in APA Leg. Hist.* 283 n.1). According to the Report, therefore, a rule may, as in this case, be effective in the "future," yet, once effective, "deal[] with past transactions."

Senate consideration of the bill, as amended and passed by the House, confirms that the legislators did not believe that the new House language barred retroactive rules. The Senate sponsor of the legislation stressed that the Attorney General had concluded that "the amendments which had been made by the House * * * were merely explanatory in nature" (92 Cong. Rec. 5790 (1946) (remarks of Sen. McCarren), *reprinted in APA Leg. Hist.* 422; see H.R. Rep.

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than merely pronounce existing rights or liabilities."). See H.R. Rep. 1980, *supra,* at 49 n.1, *reprinted in APA Leg. Hist.* 283 n.1 ("The change of the language to embrace specifically rules of 'particular' as well as 'general' applicability is necessary in order to avoid controversy and assure coverage of rule making addressed to named persons. The Senate committee report so interprets the provision, and the other changes are likewise in conformity with the Senate committee report (p.11)."). "Future effect," however, may have originated in the Model Administrative Procedure Act adopted in 1944 by the National Conference of Commissioners on Uniform State Laws. See *1944 Handbook* 106-109, 329 (emphasis added) (defines rule as including "every regulation, standard, or statement of policy or interpretation of general application and *future effect* * * *"). At least one member of that Conference Committee (Professor Ralph Fuchs) also served on the Attorney General's Committee. We could find no explanation for the Conference's addition of "future effect." Compare *ibid.* with *1943 Handbook* 226-230, 231.

1980, *supra,* at 57, *reprinted in APA Leg. Hist.* 291 (letter from Attorney General Tom C. Clark)). The sponsor also assured another Senator that the House changes "do not materially affect the intent of the act" (92 Cong. Rec. 5791, *reprinted in APA Leg. Hist.* 423). With that assurance, debate on the changes by the House immediately ended and the bill was passed (*ibid.*).

c. In light of these explicit statements of legislative intent, the court of appeals plainly erred in ruling that "future effect" evinces congressional intent to prohibit retroactive rules. Congress repeatedly declined to do just that in considering proposals for legislation. And, in commenting on the addition of the "future effect" language, the House Report specifically disavowed any intention of doing so.

It is not surprising therefore that the court of appeals' decision is contradicted by the authoritative manual on the APA published by the Attorney General's Committee on Administrative Procedure one year after the statute's enactment. The Committee there concluded that "[n]othing in the Act precludes the issuance of retroactive rules when otherwise legal" (*Attorney General's Manual* 37).[24] The Manual's construction of the APA is entitled to considerable deference. See *Steadman* v. *SEC,* 450 U.S. 91, 103 n.22 (1981); *Chrysler Corp.* v. *Brown,* 441 U.S.

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[24] The Manual adds that the issuance of retroactive rules should also be "accompanied by the finding required by section 4(c)" (*Attorney General's Manual* 37), which is the finding of "good cause" that an agency must make if it wishes to make a substantive rule legally effective less than 30 days from the date of its publication. Neither the language of the APA nor its legislative history supports the Manual's apparent assumption that the good cause finding required for an early effectiveness date automatically applies to the issuance of retroactive rules. Perhaps the Committee was anticipating that certain retroactive rules would also be given early effective dates, in which case a good cause finding would, of course, be required.

281, 302 n.31 (1979); *Vermont Yankee Nuclear Power Corp.* v. *NRDC, Inc.*, 435 U.S. at 546.

C. The Secretary's Retroactive Cost Limit Rule Is not Inconsistent with the Medicare Act

There is likewise no merit to respondents' contention (Br. in Opp. 9-11) that the Medicare Act itself bars the Secretary from promulgating a retroactive cost limit rule in the context of this case. Significantly, respondents can point to no language in the text of the Medicare Act indicating that Congress enacted such a prohibition.[25] Instead, respondents principally rely (Br. in Opp. 9) on the legislative history of Section 223(b) of the Social Security Amendments of 1972, Pub. L. No. 92-603, 86 Stat. 1393, which amended Section 1861(v)(1)(A) to allow the Secretary to promulgate cost limit rules on a presumptive and class-wide basis.[26] In commenting on this change, the House and Senate reports contrast the Secretary's new

[25] The amendatory language relied upon by respondents (42 U.S.C. (& Supp. III) 1395x(v)(1)(A)) provides that regulations "may provide for the establishment of limits on the direct or indirect overall incurred costs or incurred costs of specific items or services or groups of items or services to be recognized as reasonable based on estimates of the costs necessary in the efficient delivery of needed health services to individuals covered by the insurance programs established under this subchapter"). Contrary to respondents' claim (Br. in Opp. 9), the phrase "to be recognized" provides no support for their argument. That reference to a future event simply reflects the commonsense notion that reimbursement determinations, by their very nature, occur after costs have been incurred.

[26] In 1972, Congress also amended the definition of "reasonable cost" to exclude from "cost actually incurred" "any part of incurred cost found to be unnecessary in the efficient delivery of needed health services" (§ 223(a), 86 Stat. 1393 (42 U.S.C. 1395x(v)(1)(A)). The Secretary's new authority to promulgate cost limit rules was in furtherance of this legislative change in the statutory measure of "reasonable cost."

authority to issue cost limit rules with the prior medicare cost reimbursement scheme, under which excessive costs could be disallowed only on a case-by-case basis. The reports state that the new "authority to set limits on costs recognized for certain classes of providers * * * would be exercised on a prospective, rather than retrospective, basis so that the provider would know in advance the limits to Government recognition of incurred costs and have the opportunity to act to avoid having costs that are not reimbursable." H.R. Rep. 92-231, 92d Cong., 1st Sess. 83 (1971); S. Rep. 92-1230, 92d Cong., 2d Sess. 188 (1972).

The validity of the Secretary's 1984 cost limit rule, however, does not depend on the scope of the Secretary's authority to promulgate cost limit rules in the first instance, which is the focus of the statements upon which respondents rely. Rather, its validity turns on the scope of an agency's authority, following judicial invalidation of a wholly prospective cost limit rule because of procedural irregularities, to promulgate a new rule on remand that applies to the same time period that would have been covered by the invalidated rule. Different considerations apply in the context of a judicial remand.[27]

First, invalidation of the agency's prior rule does not eliminate the agency's duty to fulfill its statutory mandate, which, as in this case, may warrant the promulgation of a retroactive rule. For example, where the invalidated rule is the first ever promulgated by the agency to implement a federal program, congressional intent could be wholly undermined if, as respondents argue, the agency were unable to promulgate new rules that apply to the same

[27] For this same reason, respondents' reliance on a series of statements by the Secretary that certain cost limit rules would operate prospectively is equally misplaced (see Br. in Opp. 10-11). Respondents refer to no statement by the Secretary that the Medicare Act bars the issuance of a retroactive cost limit rule following judicial invalidation of the Secretary's prior rule on procedural grounds.

time period. See *Addison* v. *Holly Hill Fruit Products, Inc.*, 322 U.S. at 619-622. The same concerns apply, albeit to a lesser degree, in a case such as this one where the invalidated rule is not the first promulgated following the statute's enactment. Cf. *SEC* v. *Chenery Corp., supra*; *Burlington Northern Inc.* v. *United States, supra* (invalidation of rate order does not "revive" earlier outdated rate order). At stake in this case is fulfillment of Congress's determination that a provider "should not be shielded from the economic consequences of its inefficiency," including excessively high labor costs. See H.R. Rep. 92-231, *supra*, at 83, 84; see also S. Rep. 92-1230, *supra*, at 187, 188. That purpose would be wholly frustrated if procedural irregularities were allowed to immunize providers from cost limit rules designed to root out such inefficiencies.

Moreover, because the substance of the 1984 cost limit rule does not differ from the prospective rule promulgated in 1981 prospectively, the Secretary's curative rulemaking did not interfere with the providers' ability to "know in advance the limits to Government recognition of incurred costs"; nor did it deny the provider "the opportunity to act to avoid having costs that are not reimbursable." H.R. Rep. 92-231, *supra*, at 83; S. Rep. No. 92-1230, *supra*, at 188. The 1981 rules put respondents on notice, before they are incurred, of how wage costs for which they subsequently sought reimbursement under the Medicare Act would be computed. Hence, the concerns expressed in the legislative history are not implicated here and do not support invalidation of the Secretary's 1984 cost limit rule.

D. The Secretary's Decision to Apply His 1984 Cost Limit Rule Retroactively Was not Arbitrary and Capricious

Respondents may also argue that, even if neither the APA nor the Medicare Act specifically prohibits retroactive cost limit rules, the Secretary's 1984 cost limit rule is

invalid because the Secretary's decision to adopt a retroactive rule was itself arbitary and capricious.[28] We, of course, agree that the absence of any prohibition on retroactive rules in either the APA or the Medicare Act does not mean that the Secretary's decision to promulgate a retroactive rule must be upheld in every case. The Secretary's exercise of his general rulemaking authority to adopt a retroactive rule must be set aside if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" (5 U.S.C. 706(2)(A)). Unlike respondents, however, we do not believe that the Secretary's 1984 decision runs afoul of that standard of review.

The touchstone for determining whether an agency's decision to adopt a retroactive rule is arbitrary and capricious is this Court's decision in *SEC* v. *Chenery Corp.*, 332 U.S. 194 (1947), which upheld the retroactive application of a new principle of law in the context of an adjudication. The Court there stated that "such retroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal or equitable principles. If that mischief is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law." *Id.* at 203.[29]

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[28] Respondents also suggest (Br. in Opp. 24-25) that the judgment of the court of appeals should be affirmed based on substantive defects in the rule. Because neither the court of appeals nor the district court reached that issue, however, we do not believe this Court should address this contention in the first instance. If the Court agrees that the Secretary was not barred from promulgating retroactive rules and that its decision to adopt such a rule in 1984 was not arbitrary and capricious, the Court should reverse the court of appeals' judgment and remand the case for consideration of any remaining issues that were raised below by respondents.

[29] Of course, the issuance of a retroactive rule must be consistent with the Constitution. The Court has concluded that "[t]he retroactive

The Secretary's decision in 1984 to promulgate a retroactive rule easily satisfies this test. First, the purpose of the retroactive regulation is to avoid a windfall by respondents at the expense of the government: the recovery of approximately $2 million in costs that the Secretary has deemed to be inefficiently incurred, and which, for that reason, should not be reimbursed by Medicare.[30] As we have discussed (pages 15-18, *supra*), respondents have no legitimate claim of entitlement to reimbursement based on their invalidation of the 1981 rule on procedural grounds. The district court's ruling in 1983 entitled them to certain notice and comment procedures should the Secretary decide to reissue the rule, but not to any specific substantive result. In addition, the 1984 retroactive cost limit rule benefited more hospitals than it burdened. See 49 Fed. Reg. 6177 (1984) (retroactive rule "avoids placing an unwarranted hardship and burden on intermediaries and many hospitals, while it would impose only a minimal burden on few hospitals"). The public interest therefore weighs strongly in favor of the retroactive rule to avoid both any undue windfall to respondents and undue burden on other providers.

Second, respondents can claim no reasonable reliance interest because the 1984 retroactive rule is merely curative

aspects of legislation, as well as the prospective aspects, must meet the test of due process, and the justifications for the latter may not suffice for the former." *Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1, 16-17 (1976). That due process standard requires a "showing that the retroactive application of the [regulation] is itself justified by a rational * * * purpose." *Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, 467 U.S. 717, 730 (1984). Respondents, however, have not challenged the constitutionality of the Secretary's 1984 cost limit rule.

[30] For the purpose of considering respondents' claim that the Secretary's decision to apply his 1984 cost limit rule retroactively was arbitrary and capricious, the substance of that rule—which was not questioned by the court of appeals or district court—is presumptively valid. See note 28, *supra*.

in character. "[T]he individual who claims that a vested right has arisen from the defect is seeking a windfall since, had the legislature's or administrator's action had the effect it was intended to and could have had, no such right would have arisen." Hochman, *supra,* 73 Harv. L. Rev. at 705. In this case, respondents incurred all the relevant costs before the 1981 regulation was invalidated by the district court. Consequently, respondents had ample notice that the reasonableness of those costs would be assessed against the standard ultimately contained in the 1984 rule. Certainly there is no reason to believe that respondents would have acted differently but for the nominal retroactivity of the 1984 rule.[31]

Finally, the voluntary nature of the Medicare program, coupled with respondents' longstanding knowledge that "retroactive corrective adjustments" of one form or another were authorized by Section 1861(v)(1)(A)(ii) of the Act,[32] further diminishes the strength of respondents' claims that retroactive application of the 1984 cost limit rule is somehow unfair. " 'When providers joined the [Medicare] program, they knew that "small repairs" in the regulatory scheme were likely;' indeed, the statute warned that they would be reimbursed only for 'reasonable cost' and that retroactive adjustments might be necessary to ensure that no overpayments were made." *Daughters of*

[31] See *Illinois* v. *Bowen,* 786 F.2d 228, 292 (7th Cir. 1986) ("A critical question is how the conduct or practices of the [plaintiff] would have been different if the current interpretation of the regulations had applied from the start."); *Adams Nursing Home of Williamstown, Inc.* v. *Mathews,* 548 F.2d 1077, 1081 (1st Cir. 1977) ("In any retroactivity challenge, a central question is how the challenger's conduct * * * would have differed if the law in issue had applied from the start.").

[32] As discussed at pages 40-47, *infra,* Section 1861(v)(1)(A)(ii) also independently authorizes retroactive application of the Secretary's 1984 cost limit rule.

Miriam Center for the Aged v. *Mathews,* 590 F.2d 1250, 1261 (3d Cir. 1978) (quoting *Adams Nursing Home of Williamstown, Inc.* v. *Mathews,* 548 F.2d 1077, 1081 (1st Cir. 1977)). Indeed, because providers, such as respondents, are equally entitled under the statutory scheme to retroactive *increases* in reimbursement in appropriate circumstances, they are especially hard pressed to complain about unfairness in retroactive *decreases.* See *Fairfax Nursing Center, Inc.* v. *Califano,* 590 F.2d 1297, 1300 (4th Cir. 1979).[33]

II. SECTION 1861(v)(1)(A)(ii) OF THE MEDICARE ACT SPECFICALLY AUTHORIZES THE SECRETARY'S PROMULGATION OF A RETROACTIVE COST LIMIT RULE TO PREVENT EXCESSIVE REIMBURSEMENT

Even if the 1984 retroactive cost limit rule were somehow invalid as an exercise of the Secretary's general rulemaking authority, Section 1861(v)(1)(A)(ii) of the Medicare Act, 42 U.S.C. (Supp. III) 1395x(v)(1)(A) (Clause (ii)), independently authorizes the Secretary to promulgate such a rule.[34]

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[33] The district court reached a contrary conclusion in applying the balancing test set forth in *Retail, Wholesale & Dep't Store Union* v. *NLRB, supra* (Pet. App. 35a-39a). Its analysis is flawed by its failure to recognize that respondents' reliance interest must be assessed as of the time they engaged in the underlying conduct. The court erroneously concluded that respondents had a cognizable reliance interest in retaining the windfall they obtained by virtue of the Secretary's procedural error. The court also erred in finding that the public interest weighed against the application of the revised methodology for calculation of the indices without first finding that that methodology was substantively invalid. If the methodology is valid (which must be assumed (see notes 28, 30, *supra*)), it is, by definition, the proper approach for calculating the reasonable cost. Any award in excess of that amount violates the statute and therefore is contrary to the public interest.

[34] The court of appeals wrongly suggested that the Secretary cannot rely on Clause (ii) as authority for his 1984 rule because he failed to cite to that specific provision or make specific findings under it in promulgating those rules (see Pet. App. 16a). But the Secretary did expressly invoke Section 1861(v)—of which (v)(1)(A)(ii) is a subsection—as authority for the issuance of the 1984 rule. See 49 Fed. Reg. 6180 (1984); *id.* at 46501. Surely the Secretary is not required to list separately every subsection upon which he specifically relies in promulgating a rule. In any event, as noted by this Court in *Massachusetts Trustees of Eastern Gas & Fuel Associates* v. *United States,* 377 U.S. 235, 247-248 (1964), an agency's failure to invoke the correct statutory authority does not require invalidation of the agency's action where "a mistake of the administrative body is one that clearly had no bearing on the procedure used or the substance of the decision reached." See also *NLRB* v. *Wyman-Gordon Co.,* 394 U.S. 759, 767 n.6 (1969); *Illinois* v. *ICC,* 722 F.2d 1341, 1348-1349 (7th Cir. 1983); cf. *Baylor University Medical Center* v. *Heckler,* 758 F.2d 1052, 1060 n.14 (5th Cir. 1985). That principle plainly applies here.

1. Clause (ii) empowers the Secretary of Health and Human Services to issue regulations that "provide for the making of suitable retroactive corrective adjustments where * * * the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive." There is considerable disagreement among the lower courts regarding the scope of the Secretary's authority under this provision.[35] As the court

[35] Some courts of appeals have concluded that "[u]pon determining that one of his cost reimbursement regulations produces inadequate or excessive reimbursement payments to providers, the Secretary has a statutory duty [under Clause (ii)] to make suitable retroactive corrective adjustments" through the issuance of regulations. *Springdale Convalescent Center* v. *Mathews,* 545 F.2d 943, 954 (5th Cir. 1977). These courts have held that the Secretary may—and in some circumstances must—apply revised cost reimbursement regulations retroactively where the prior rule resulted in an improper level of reimbursement. *Ibid.*; see also Pet. 13-14 (citing cases). The court below took a narrower view of Clause (ii), holding that the provision does not empower the Secretary to issue retroactive rules, but only authorizes retroactive adjustment of reimbursement awards on a case-by-case basis upon proof that a particular reimbursement award was either inadequate or excessive. Pet. App. 16a-19a; see also Pet. 14. A third group of courts

of appeals itself acknowledged (Pet. App. 16a (footnote omitted)), the courts "have struggled to define the precise contours of the retroactive correct adjustments provision."

In the Secretary's view, Clause (ii) authorizes the Secretary to issue a retroactive regulation of general application where, as in this case, the application of a prior cost reimbursement regulation has resulted in systemically excessive or inadequate reimbursement. The validity of the Secretary's construction depends, of course, on its reasonableness. See, *e.g.*, *Young* v. *Community Nutrition Inst.*, 476 U.S. at 980-981; *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. at 842-844; *Chemical Mfrs. Ass'n* v. *NRDC, Inc.*, 470 U.S. 116, 125 (1985). Where "Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation." *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. at 842. Rather, the only question is whether the Secretary's understanding of the statute is "sufficiently rational to preclude a court from substituting its judgment for that of the [Secretary]." *Young* v. *Community Nutrition Inst.*, 476 U.S. at 981; see *Chemical Mfrs. Ass'n* v. *NRDC, Inc.*, 470 U.S. at 125. Indeed, even if the "Court of Appeals' reading of the statute may seem to some to be the more natural interpretation," the Secretary's view must be upheld so long as the "phrasing * * * admits" of that reading. See *Young* v. *Community Nutrition Inst.*, 476 U.S. at 980.

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has stated that the provision does not permit any retroactive reassessment of reimbursement decisions, but only directs the Secretary "to promulgate regulations that mandate retroactive adjustments in the *payments* received by providers, so as to bring the amounts paid to them on the basis of their monthly estimates in line with the amount actually due them under the annual audit." *Daughters of Miriam Center for the Aged* v. *Mathews*, 590 F.2d at 1258 n.23 (emphasis in original); see Pet. 14-15.

2. The Secretary's suggested interpretation of Clause (ii) is a reasonable reading of the provision; the language "admits of" the Secretary's construction, that construction is not contradicted by the provision's legislative history, and it represents a sensible attempt to accommodate Congress's purposes and considerations of administrative feasibility.

a. First, contrary to the court of appeals' assertion (Pet. App. 16a-17a), the language does not "plainly" refute the Secretary's view. Clause (ii) does not, as respondents suggest (Br. in Opp. 13 (emphasis omitted)), provide that the Secretary may issue regulations only for the purpose of establishing a "process" for making "case-by-case" adjustments for "particular providers." The words "process," "case-by-case," and "particular providers" do not appear anywhere in Clause (ii). To the contrary, the statute broadly authorizes the Secretary to issue "regulations" that "provide for the making of suitable retroactive corrective adjustments," without limiting the Secretary's methodology for doing so. As applied to this case, the prior (1979) cost limit rule constitutes a "method[] of determining costs" that the Secretary has determined was leading to "excessive" reimbursement. The 1984 cost limit rule is, accordingly, a regulation for the purpose of "making * * * suitable retroactive corrective adjustments."[36]

To be sure, the language of Clause (ii) is clearly broad enough to *permit* the Secretary to decide that retroactive corrective adjustments would best be achieved in certain circumstances through case-by-case adjudications directed

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[36] The reference in Clause (ii) to "a provider of services" is not to the contrary. It simply means that the Secretary must provide for the making of retroactive adjustments for "a" provider, but does not state how the Secretary must do so. In particular, the provision does not state that the Secretary must conduct a separate proceeding for each individual provider.

to particular providers.[37] But, contrary to respondents' claim, the language of Clause (ii) does not adopt case-by-case adjudication as the *exclusive* procedure available to the Secretary in all circumstances. It focuses solely on the "method" that prompted the erroneous reimbursement—which in this case was a cost limit rule—and authorizes the Secretary to promulgate "regulations" to redress that error.[38] "[M]ethods" of reimbursement differ and those differences may properly influence the Secretary's determination of the most suitable manner of making a retroactive corrective adjustment.

Indeed, the sentence in which Clause (ii) appears begins with the phrase "[s]uch regulations." That reference logically includes those "regulations" that the Secretary is authorized to promulgate "for the establishment of limits on * * * incurred costs" (42 U.S.C. (& Supp. III) 1395x(v)(1)(A)). Thus, the literal language of the statute provides that cost limit regulations shall provide for "suitable retroactive corrective adjustments." The fact that Clause (ii) was enacted in 1965, before the cost limit rules were authorized (see page 34, *supra*), does not undermine this point. The Secretary may reasonably construe the meaning of Clause (ii) in accordance with the settled

[37] The Secretary's cost limit regulations do establish an exceptions process through which an individual provider may seek a reclassification, an exemption or exception from cost limits, or an adjustment of inpatient operating costs. See 42 C.F.R. 413.30(d)-(h).

[38] Contrary to the court of appeals' suggestion (Pet. App. 12a n.11), moreover, our construction of Clause (ii) would not allow the Secretary to make his regulations retroactive for an unlimited period of time. Clause (ii) does not override other provisions of the Medicare Act. Thus, when a reimbursement award is final and no longer subject to reopening (see 42 C.F.R. 405.1885), that award cannot be reconsidered pursuant to a rule issued under Clause (ii). See 51 Fed. Reg. 11188 (1986) (stating that retroactive application of medical malpractice cost standard is limited to cost reports not yet closed and cost reports still subject to reopening).

principle of statutory construction that "the provisions introduced by the amendatory act should be read together with the provisions of the original section that were reenacted or left unchanged, in the amendatory act, as if they had been originally enacted as one section." See 1a N. Singer, *Statutes and Statutory Construction* § 22.34, at 293 (4th ed. 1985) (footnotes omitted); see also *id.* § 22.35, at 296.

b. Nor does the legislative history "plainly" or "unambiguously" support the court of appeals' and respondents' narrow reading of Clause (ii), and thus require rejection of the Secretary's own construction. Indeed, respondents and the court of appeals do not cite to any legislative history that discusses the meaning of Clause (ii). They rely instead exclusively on legislative history pertaining to the meaning of Section 223(b) of the Social Security Amendments of 1972, which amended Section 1861(v)(1)(A) to authorize the Secretary to establish cost limit rules for the Medicare program. As previously discussed (page 35, *supra*), the Senate and House reports accompanying that amendment suggest that cost limit rules would generally operate prospectively. That legislative history, however, sheds little, if any, light on the meaning of Clause (ii). The amendment was adopted seven years after Clause (ii) was enacted; it left the language of Clause (ii) intact;[39] and its legislative history never even mentions Clause (ii), let alone discusses the relationship of Clause (ii) to the Secretary's authority to promulgate cost limit rules.[40]

[39] Prior to the 1972 amendments, however, Clause (ii) was contained in Section 1861(v)(1)(B). See 42 U.S.C. (1970 ed.) 1395x(v)(1)(B).

[40] In addition, as we discussed previously (pages 35-36, *supra*), those statements do not in any event have any bearing on the validity of a curative rule, such as the Secretary's 1984 cost limit rule, because it is only nominally retroactive and does not deprive the provider of fair notice.

Most fundamentally, the legislative history nowhere states that Clause (ii)'s reference to "such regulations" should not apply equally to the cost limit rules and, hence, allow for their retroactive correction. In the absence of such legislative history, it is reasonable for the Secretary to conclude, consistently with the statutory language, that Congress determined that retroactive correction of cost limit rules, like other "methods of determining costs," was appropriate where the "aggregate reimbursement produced * * * proves to be either inadequate or excessive."

c. Finally, the Secretary's construction of Clause (ii) should be upheld because here, as in *Young* v. *Community Nutrition Inst.*, 476 U.S. at 982, it is "sensible." Congress in 1972 amended the Medicare Act to redefine "reasonable costs" to exclude costs inefficiently incurred and, to that end, to authorize the Secretary to promulgate class-wide cost limit rules (see pages 4, 34 & note 26, *supra*). Congress described the new limits as "ceilings," the purpose of which was "to prevent Government programs from picking up" unreasonable costs. Moreover, the reimbursement program could be implemented "on a class and presumptive basis." H.R. Rep. 92-231, *supra*, at 84; see also S. Rep. 92-1230, *supra*, at 188, 189.

A scheme for "retroactive corrective adjustments" through rules of general application is a sensible, indeed necessary, complement to these changes, particularly Congress's authorization of class-wide cost limit rules. Errors in such rules are often best redressed by changes in the rules themselves, and only retroactive application of those changes will achieve an "adjustment" in the prior erroneous reimbursement award.

In contrast, the construction of Clause (ii) proffered by respondents and the court of appeals would frustrate Congress's overriding purpose of ensuring that hospitals are reimbursed only for their costs that are necessary "in the efficient delivery of needed health services" (42 U.S.C.

(Supp. III) 1395x(v)(1)(A)). Respondents do not deny that the Secretary can make "retroactive corrective adjustments" where a provider's reimbursement levels were initially established by cost limit rules. Nevertheless, respondents apparently would require the Secretary to make such adjustments by undertaking a separate adjudication for each individual provider in which it would be necessary to prove both the flaws in the old reimbursement methodology and the propriety of the new standard. As the Fifth Circuit has observed, however, "regulation [of Medicare reimbursement] cannot be accomplished on a hospital-by-hospital basis." *City of Austin, Brackenridge Hosp.* v. *Heckler*, 753 F.2d 1307, 1317 (5th Cir. 1985). A retroactive rule is the only workable method of achieving "retroactive corrective adjustments" where, as in this case, the Secretary has determined that a flaw in a prior cost limit rule is systematically leading to "excessive reimbursement" in a broad class of cases.[41]

Unlike respondents, we cannot suppose that Congress, when it amended the Medicare Act in 1972 in an effort to prevent the government from paying for the inefficiences of others, intended to require such a wasteful and duplicative administrative practice. In any event, the Secretary's conclusion that Congress harbored no such intent is "sufficiently rational" to be upheld. See *Young* v. *Community Nutrition Inst., supra.*

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[41] Conversely, where an existing cost limit rule is systematically leading to "inadequate reimbursement," within the meaning of Clause (ii), a retroactive rule may likewise be appropriate. Compare *St. Paul-Ramsey Medical Center* v. *Bowen*, 816 F.2d 417 (8th Cir. 1987). Clearly, however, retroactive rules are authorized by Clause (ii) in either both "inadequate" and "excessive" reimbursement cases, or in neither circumstance.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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* The Solicitor General is disqualified in this case.

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